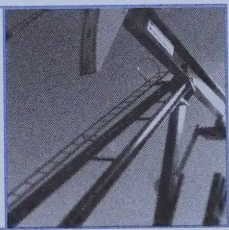
Thunder Energy Inc.

2004

Management's Discussion & Analysis
and Financial Statements



Management's Discussion and Analysis

The following discussion is management's analysis of Thunder Energy Inc.'s ("Thunder" or the "Company") operating and financial data for 2004 and prior years, as well as estimates of future operating and financial performance based on information currently available. It should be read in conjunction with the audited consolidated financial statements and notes for the years ended December 31, 2004, 2003 and 2002. The Management Discussion and Analysis was prepared as of March 11, 2005.

Basis of presentation – The financial data presented below has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The reporting and the measurement currency is the Canadian dollar.

Non-GAAP Measurements – This Management's Discussion and Analysis contains the term cash flow from operations, which should not be considered an alternative to, or more meaningful than, cash flow from operating activities or net income as determined in accordance with Canadian generally accepted accounting principles as an indicator of the Company's performance. Thunder's determination of cash flow from operations may not be particularly comparable to that reported by other companies especially those in other industries. It is presented because management believes the information is useful for investors as it is used internally and widely accepted by those following the oil and gas industry as a financial indicator of a company's ability to generate cash to internally fund exploration and development activities and service debt. This term is also used by research analysts to value and compare oil and gas exploration and production companies, and is frequently included in published research when providing investment recommendations. The reconciliation between net earnings and cash flows from operations can be found in the consolidated statements of cash flows in the audited consolidated financial statements. The Company also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. The terms return on capital employed and return on shareholders' equity are also used in this Management Discussion and Analysis. These earnings measures are not recognized by GAAP and do not have a standardized meaning prescribed by GAAP. These indicators are not an alternative to, or meaningful than, GAAP performance measures. Return on capital employed is calculated as net income divided by the average of opening and closing long-term liabilities and shareholders' equity. Return on shareholders' equity is calculated as net income divided by the average opening and closing shareholders' equity.

BOE presentation – The term barrels of oil equivalent (boe) may be misleading, particularly if used in isolation. The boe conversion ratio used by the Company of 6 mcf: 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in this report are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil.

FORWARD-LOOKING STATEMENTS

Statements throughout this annual report that are not historical facts may be considered "forward-looking statements." These forward-looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company's objectives, goals or future plans are forward-looking statements. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to any number of factors, including such variables as new information regarding recoverable reserves, changes in demand for, and commodity prices of crude oil and natural gas, legislative, environmental and other regulatory or political changes, competition in areas where the Company operates and other factors discussed in this annual report.

CORPORATE STRATEGY

The environment in which we operate our business has elements of uncertainty, the most significant being shifts in commodity prices and the risks associated with exploring for oil and natural gas. Management and the Board of Directors have devised a business strategy that responds to both exploration risks and operational performance at all levels of the commodity price cycle.

Thunder closed its strategic merger with Impact Energy Inc. ("Impact") on April 30, 2004, which has created a company with a strong base of production and exceptional growth opportunities in Western Canada. Thunder has continued its growth in 2004 through the exploitation of shallow gas assets in central Alberta to maintain base production and continues to investigate coal bed methane ("CBM"). With the merger, we have expanded into large reserve discoveries in North East B.C. and the Alberta Foothills.

Management and the Board also believe that Thunder must maintain a financial structure that is both low cost and flexible. As a more diversified producer we are focused more than ever on costs and maintaining high margins. Through our shallow gas assets, Thunder is able to quickly deploy capital and ramp up activity to capture the benefit of high prices. Cash flow generated from these assets is leveraged for growth in high-impact areas.

While these strategies are part of our business focus, we believe that flexibility and rapid response to changing market conditions are critical to capturing opportunities, and ensuring continued growth and value for our shareholders.

FINANCIAL RESULTS

($000s, except per share data)	2004	2003	2002
Petroleum and natural gas sales	116,409	102,201	67,168
Cash flow from operations	63,978	56,718	36,584
Per share – basic *($)*	1.45	1.81	1.18
Per share – diluted *($)*	1.41	1.74	1.15
Net income	15,928	23,610	11,951
Per share – basic *($)*	0.36	0.75	0.39
Per share – diluted *($)*	0.35	0.72	0.37
Capital expenditures	93,245	69,943	35,442
Net debt including working capital deficiency and capital lease obligations	107,437	82,956	70,802
Total assets	476,232	238,100	237,249

PETROLEUM AND NATURAL GAS SALES

Oil and gas revenues increased 14% to $116.4 million for the year ended December 31, 2004 compared with the same period in 2003 due to stronger commodity pricing and a 12% increase in natural gas production offset by a 14% decline in oil and NGLs production. Natural gas prices averaged 3% higher than in 2003, while average oil and NGLs pricing jumped 24%.

The financial statements for the year ended December 31, 2004 have been restated to segregate costs associated with the transportation and selling of natural gas, crude oil and NGLs. Previously, Thunder followed the industry practice of presenting revenues net of these costs. The table below calculates revenue and segregates transportation costs.

Petroleum and Natural Gas Sales ($000s)	2004	2003	2002
Natural gas	95,651	82,729	47,129
Crude oil and NGLs	20,758	19,472	20,039
Gross revenue	116,409	102,201	67,168
Transportation expenses	(4,225)	(4,011)	(3,330)
Net revenue	112,184	98,190	63,838

Sales Variance Analysis ($000s, net of transportation expenses)	2004	2003	2002
Natural gas sales			
Volume increase	9,972	5,083	9,421
Price increase (decrease)	2,809	29,729	(13,935)
Net gas sales change	12,781	34,812	(4,514)
Crude oil and NGLs sales			
Volume increase (decrease)	(2,589)	(1,605)	1,561
Price increase (decrease)	3,802	1,145	2,917
Net crude oil and NGLs sales change	1,213	(460)	4,478
Combined sales change	13,994	34,352	(36)

Production	2004	2003	2002
Natural gas *(mcf/d)*	38,887	34,590	31,086
Crude oil and NGLs *(bbls/d)*	1,309	1,522	1,665
Total *(boe/d)*	7,790	7,288	6,846
Percentage gas *(%)*	83	79	76

MARKETING

The Company markets its natural gas in the Alberta spot market and through aggregators, which sell to major markets in Canada and the United States. Aggregator prices are based on a combination of term and spot markets. Crude oil and NGLs are sold on a spot basis at various delivery points in Alberta. Prices received for crude oil and NGLs are determined by the quality of the crude compared to a benchmark price for light sweet oil. Thunder's composite crude oil is a medium blend averaging approximately 25° API; whereas, the Edmonton light price is 40° API.

Thunder markets the majority of gas sales to the higher value Alberta spot market. In 2004, 72% (2003 – 60%; 2002 – 65%) of natural gas sales were to the Alberta spot markets.

Thunder's average price for crude and NGLs was discounted to the Edmonton light posted price by $11.68/bbl (2003 – $10.25/bbl; 2002 – $9.11). The quality of Thunder's crude remained at 25° API.

Average Commodity Prices	2004	2003	2002
Natural gas *($/mcf)*			
NYMEX *($US/mcf)*	6.18	5.49	3.25
AECO	6.55	6.70	4.18
Thunder price before transportation	6.70	6.53	4.14
Transportation	(0.21)	(0.22)	(0.18)
Thunder price at the wellhead	6.49	6.31	3.96
Crude oil and NGLs *($/bbl)*			
WTI *($US/bbl)*	41.40	31.04	26.08
Edmonton posted	52.54	43.14	32.91
Thunder price before transportation	43.34	35.04	32.97
Transportation	(2.48)	(2.15)	(2.14)
Thunder price at the wellhead	40.86	32.89	30.83
Cdn/US $ average exchange rate	1.299	1.401	1.570

Transportation expenses increased 5% over 2003 to $4.2 million. Transportation per mcf declined 5% in 2004 from 2003. Oil and NGLs transportation expense increased 15% per bbl. These amounts relate to the cost of transporting natural gas on the main natural gas pipelines and for oil trucking charges. In the past, these amounts were offset against revenue and not disclosed separately. Prior periods have been restated to reflect this change in presentation.

ROYALTIES

Thunder's overall royalties decreased in 2004 compared to 2003 due to increasing gas cost allowance claims. Additionally, Thunder received a $0.7 million gas cost allowance adjustment relating to 2003 as well as a $0.3 million refund as a result of a prior period royalty dispute. Before these two adjustments Crown royalties as a percentage of net revenue was 1% higher which would have resulted in overall net royalties as a percentage of net revenue of 19%.

Royalties ($000s)	2004	2003	2002
Crown	17,607	18,747	8,784
Freehold and other	3,815	3,304	2,728
Total gross royalties	21,422	22,051	11,512
ARTC	(500)	(444)	(293)
Net royalties	20,922	21,607	11,219

Royalty Rates (as a % of revenue, net of transportation expenses)	2004	2003	2002
Crown	16	19	14
Freehold and other	3	4	4
Total gross royalties	19	23	18
ARTC	(1)	(1)	–
Net royalties	18	22	18

HEDGING

The Company was a party to an off balance sheet power contract, a derivative financial instrument, in 2004, 2003 and 2002. The contract fixes the price of twenty-four megawatt hours ("MWh") of electricity per day at $78.00 per MWh and runs through December 31, 2005. Operating expenses for the year ended December 31, 2004 include costs of $206,000 (2003 – $131,000; 2002 – $325,000) associated with this contract. At December 31, 2004 this contract was out of the money by $320,000. This represents the amount the Company would be required to pay to terminate the contract. This instrument has no book value recorded in the consolidated financial statements.

Thunder has no hedges in place relating to future period production at December 31, 2004.

OPERATING EXPENSES

Operating costs increased 24% to $6.77/boe in 2004 from 2003. The increase reflects the industry as a whole experiencing higher costs, and the effect of the Impact acquisition, which had higher operating costs per boe due to the nature of its assets.

Operating Costs	2004	2003	2002
Operating costs *($000s)*	19,299	14,480	10,824
Per boe *($)*	6.77	5.44	4.30

GENERAL AND ADMINISTRATIVE EXPENSES

Gross general and administrative expenses (G&A) increased 70% in 2004 compared to 2003 due to grass roots growth and the Impact acquisition. Significant increases in employees and office space resulted in the majority of the rise in costs. Also included in G&A is a one-time integration cost of $0.5 million. Gross G&A expense per boe would have been $2.58 ($1.32 net) excluding this one-time cost. Thunder does not capitalize indirect overhead.

G&A Expenses ($000s)	2004	2003	2002
Gross cash G&A expenses	7,849	4,615	3,763
Overhead recoveries			
– Capital	(2,323)	(1,273)	(729)
– Operating	(1,262)	(1,093)	(879)
Total overhead recoveries	(3,585)	(2,366)	(1,608)
Net cash G&A expenses	4,264	2,249	2,155

G&A Expenses per BOE ($)			
Gross G&A expenses per boe	2.75	1.74	1.50
Overhead recoveries per boe			
– Capital per boe	(0.81)	(0.48)	(0.29)
– Operating per boe	(0.44)	(0.41)	(0.35)
Total overhead recoveries per boe	(1.25)	(0.89)	(0.64)
Net G&A expenses per boe	1.50	0.85	0.86

INTEREST EXPENSE

Interest expense rose 13% over 2003 due to higher bank debt as Thunder's capital activity level increased. This increase in debt was offset by a slightly lower interest rate.

Interest Expense	2004	2003	2002
Interest expense *($000s)*	3,094	2,740	2,725
Average revolving demand bank debt outstanding *($000s)*	80,020	67,166	66,638
Effective annualized interest rate for the period *(%)*	3.9	4.1	4.1

DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion (DD&A) expenses increased $4.08 per boe over 2003. The DD&A rate rose as a result of an increase in general industry costs and a 9% decrease in proven reserves. DD&A also includes the depreciation of the asset retirement obligation included in property and equipment and the accretion expense related to the asset retirement obligation liability. Prior year DD&A has been adjusted to reflect depletion and accretion expense related to the asset retirement obligation as the application of the accounting policy was retroactive.

Depletion, Depreciation and Accretion *($000s, except where noted)*	2004	2003	2002
Oil and gas depletion	27,647	17,079	12,927
Oil and gas depreciation	7,699	4,911	4,017
Other depreciation	(99)	243	51
Accretion	953	702	589
Total	36,200	22,935	17,584
DD&A Rate *($/boe)*	12.70	8.62	7.04

SHARE CAPITAL

Share capital increased by $148.5 million over 2003 due to the Impact acquisition, issuance of flow-through shares and exercise of stock options.

Common shares	Number of shares	$ Thousands
Balance December 31, 2002	30,972,227	39,927
Issued for cash on exercise of stock options	589,835	1,154
Balance December 31, 2003	31,562,062	41,081
Issued for cash on exercise of stock options	1,000,602	3,091
Issued on Impact acquisition	18,100,317	135,835
Share issue costs, net of tax of $68	–	(101)
Flow-through shares issued for cash	1,000,000	10,000
Share issue costs, net of tax of $212	–	(333)
Balance December 31, 2004	51,662,981	189,573

STOCK-BASED COMPENSATION EXPENSE

Stock-based compensation expense increased to $2.5 million from $0.5 million in 2003 mainly due to 2.3 million options being issued coincident with the Impact acquisition.

INCOME TAXES

The provision for income taxes decreased slightly compared to the prior year due to an increase in non-deductible stock-based compensation and a decrease in the effect of tax rate adjustments, which more than offset the decrease in net income before taxes. The effective tax rate for the year-ended December 31, 2004 is 38% (2003 – 30%).

Tax Pools ($000s)	2004
Canadian oil and gas property expenses (COGPE)	53,367
Canadian development expenses (CDE)	64,382
Canadian exploration expense (CEE)	67,504
Undepreciated capital costs (UCC)	59,186
Non-capital tax loss carryforwards	4,286
Share issue costs	2,330
Total	251,055

CASH FLOW FROM OPERATIONS

Cash flow from operations increased 13% due to a 7% increase in total production from 2003; a 24% increase in oil and NGL prices and 3% increase in gas prices.

Cash Flow from Operations	2004	2003	2002
Cash flow from operations *($000s)*	63,978	56,718	36,584
Per share – basic *($)*	1.45	1.81	1.18
Per share – diluted *($)*	1.41	1.74	1.15
Cash flow per boe *($)*	22.44	21.32	14.67
Cash flow as a percentage of gross sales *(%)*	55	55	54

NET INCOME

Net income decreased 33% compared to 2003. The decrease was primarily due to increased DD&A, stock-based compensation, and changes in tax rates from previous periods.

Net Income	2004	2003	2002
Net income *($000s)*	15,928	23,610	11,915
Per share – basic *($)*	0.36	0.75	0.39
Per share – diluted *($)*	0.35	0.72	0.37
Net income per boe produced *($)*	5.59	8.88	4.77
Return on shareholders' equity *(%)*	9	28	9
Return on capital employed *(%)*	7	19	12

	Gas *($/mcf)*			Crude Oil and NGLs *($/bbl)*		
Netback Analysis	2004	2003	2002	2004	2003	2002
Selling price	6.49	6.31	3.96	40.86	32.89	30.83
Royalties (net of ARTC)	1.34	1.33	0.77	3.89	3.85	3.87
Production expenses	1.10	0.97	0.75	7.71	3.80	4.46
Operating netback	4.05	4.01	2.44	29.26	25.24	22.50

Barrels of Oil Equivalent ***($/boe)***	2004	2003	2002
Selling price	39.35	36.91	25.55
Royalties (net of ARTC)	7.34	8.12	4.49
Production expenses	6.77	5.44	4.30
Operating netback	25.24	23.35	16.76
General and administrative	1.50	0.85	0.86
Interest	1.09	1.03	1.09
Large corporation tax expense	0.21	0.15	0.13
Cash flow netback from operations	22.44	21.32	14.68
Stock-based compensation expense	0.88	0.17	–
Depletion, depreciation and accretion	12.70	8.62	7.04
Taxes (future)	3.27	3.65	2.72
Net income	5.59	8.88	4.92

The gas operating netback increased due to increased gas production and the slight increase in gas prices, which more than offset the increase in operating costs. Additionally, Thunder's royalties decreased due to gas costs allowance adjustments as previously described.

Crude oil and NGLs netbacks decreased due to the increase in operating costs. This was due to increased water hauling expenses. Royalty rates remained steady for oil and NGLs in 2004 compared to 2003.

CAPITAL EXPENDITURES

Capital expenditures for the year totalled $93.2 million. Land acquisitions totalled $9.1 million as the Company acquired 144,000 net acres of undeveloped land. Total seismic costs came to $6.0 million for the shooting of 369 kilometres of 2D and 47 square kilometres of 3D seismic, plus the purchase of 775 kilometres of 2D seismic and 30 square kilometres of 3D seismic data. Conventional drilling, completion, equipping and tie-in costs totalled $56.9 million for the drilling of 59 gas wells (51.1 net), two oil wells (2.0 net) and nine dry holes (8.6 net). Thunder invested $15.0 million in the drilling, completion and equipping of 47 coal bed methane wells (46.6 net). The Company had an overall drilling success ratio of 92%. Facilities and gas gathering costs totalled $6.1 million and acquisition and other costs aggregated $0.1 million.

At December 31, 2004, costs of $46,288,400 (2003 – $9,884,600) related to unproven properties have been excluded from the full cost pool. The rise over 2004 is due to increases in the price per acre, total acreage and costs associated with coal bed methane pilot projects.

Capital Expenditures Summary ***($000s)***	2004	2003	2002
Land and rentals	9,138	6,578	3,633
Seismic	5,988	2,385	1,690
Conventional drilling and completions	43,411	40,200	21,075
Well equipping and tie-in	13,483	9,991	4,914
Facilities and gas gathering	6,067	7,022	1,664
Acquisitions, net of dispositions	(231)	155	2,417
Other	373	467	49
Total conventional capital expenditures	78,229	66,798	35,442
CBM drilling, completions and facilities	15,016	3,145	–
Total capital expenditures	93,245	69,943	35,442
Wells drilled gross (net)	117 (108.3)	111 (101.2)	51 (43.2)

LIQUIDITY AND CAPITAL RESOURCES

Total Capitalization ($000s)	2004	2003	2002
Working capital deficiency, excluding revolving bank loan	24,447	8,470	5,145
Revolving demand loan	82,896	74,348	65,478
Capital lease obligation	94	138	179
Future income taxes	66,934	35,652	25,942
Asset retirement obligations	13,417	10,352	8,258
Market value of common shares at December 31	387,472	263,589	170,347
Total	575,260	392,549	275,349

Liquidity

For the year ended December 31, 2004, capital expenditures of $93.2 million, abandonment costs of $0.2 million, the assumption of $6.2 million in negative working capital from Impact and Impact transaction costs of $1.1 million were funded by cash flow from operations of $64.0 million, $12.2 million in proceeds from the issuance of share capital resulting from the exercise of stock options and the issuance of $10.0 million in flow-through shares, and an increase of $24.5 million in net debt including working capital from operating and investing activities. Thunder's accounts receivable and accounts payable increased $8.1 million due to cash calls made to partners at year-end to fund the first quarter capital program. Thunder's revolving bank debt was $82.9 million at December 31, 2004. Although this loan is demand in nature and accordingly is presented as a current liability, the bank has confirmed that it is not its intention to call for repayment before December 31, 2005, provided there is no adverse change in the financial position of the Company. Thunder's bank line is $130 million at December 31, 2004.

As at March 11, 2005 there were 51,714,182 common shares and stock options to acquire an aggregate of 4,170,029 common shares outstanding.

The Company has no off-balance sheet financing arrangements other than the power contract hedge referred to in Note 9 in the consolidated financial statements.

BUSINESS COMBINATION

On April 30, 2004, the Company acquired all of the issued and outstanding common shares of Impact Energy Inc. ("Impact") on the basis of 0.22222 common shares of Thunder for each common share of Impact. The value per common share issued was calculated as the average Thunder closing share price five days before and five days after the announcement of the acquisition. Thunder issued 18,100,317 common shares as consideration and incurred $1.1 million in transaction costs. Subsequent to the date of acquisition, the preliminary allocation of the purchase price was adjusted to reflect Thunder's current understanding of fair values as at the date of acquisition. This transaction was accounted for by the purchase method, based on fair values as follows:

Net assets acquired ($000s)	
Current assets, including cash of $14	$ 2,692
Property and equipment	120,727
Goodwill	45,448
Current liabilities	(8,912)
Asset retirement obligations	(778)
Future income tax liability	(22,226)
	$ 136,951
Value of common shares of Thunder issued	$ 135,835
Transaction costs	1,116
Total consideration	$ 136,951

RELATED PARTY TRANSACTIONS

During the year the Company paid $331,000 (2003 – $53,000) for legal services from a law firm of which one of the Company's directors is a partner. At December 31, 2004, $64,000 ($Nil) remained outstanding. These transactions were in the normal course of operations and were measured at the exchange amount.

SUBSEQUENT EVENT

On March 11, 2005, the Board of Directors authorized management of Thunder to undertake examination of possible corporate restructuring alternatives to increase shareholder value. No decision on any particular alternative has been reached and there can be no assurance that the Board of Directors will determine to undertake any transaction identified and presented to it by management.

CONTRACTUAL OBLIGATIONS, COMMITMENTS AND GUARANTEES

We have assumed various contractual obligations and commitments in the normal course of our operations and financing activities. These obligations and commitments have been considered when assessing our cash requirements to our analysis of future liquidity.

			Payments		
($000s)	Total	< 1 year	1-3 years	4-5 years	> 5 years
Revolving demand loan[1]	82,896	82,896			
Firm transportation	10,426	5,771	3,433	1,051	170
Power contract	320	320			
Capital lease obligations	94	94			
Office and vehicle leases	1,034	575	445	12	2
Total	94,770	89,656	3,878	1,063	172

[1] *While the bank has confirmed that it has no intention to call for repayment of this loan before December 31, 2005, provided there is no adverse change to the financial position of the Company, this loan is demand in nature and pursuant to the Canadian accounting guidelines are presented as a current liability on the balance sheet. The Company expects that no repayment will be necessary in the foreseeable future.*

ASSET RETIREMENT OBLIGATIONS

Thunder adopted Section 3110 of the Canadian Institute of Chartered Accountants ("CICA") Handbook on January 1, 2004. As a result of implementation, the liability for future abandonment costs (the "Asset Retirement Obligations" or "ARO") was $13.4 million at December 31, 2004. For the year ended December 31, 2004, property and equipment increased by $2.1 million.

The transitional provisions of this section require that the standard be applied retroactively with restatement of comparative periods. As a result of the retroactive application, 2003 comparative numbers have been restated to reflect the impact of this standard on the 2003 financial statements. In comparison to amounts previously reported as at December 31, 2003, net income after applicable income taxes decreased by $0.5 million, ARO increased by $10.4 million, property and equipment increased by $5.1 million (net of accumulated depreciation of $3.1 million), future tax liability decreased by $1.2 million and opening 2003 retained earnings decreased by $2.1 million net of applicable income taxes. Opening 2004 retained earnings decreased by $2.6 million net of applicable income taxes for the cumulative impact of retroactive restatement of all prior years.

QUARTERLY INFORMATION

($000s, except per share data)	Q1	Q2	Q3	Q4
2004				
Petroleum and natural gas sales	28,232	30,883	28,245	29,049
Cash flow from operations	15,006	18,436	15,460	15,076
Per share – basic *($)*	0.47	0.42	0.31	0.30
Per share – diluted *($)*	0.45	0.41	0.30	0.29
Net income	5,698	5,698	3,325	1,207
Per share – basic *($)*	0.18	0.13	0.07	0.02
Per share – diluted *($)*	0.17	0.13	0.06	0.02
2003				
Petroleum and natural gas sales	29,093	22,836	25,065	25,207
Cash flow from operations	17,329	12,195	13,657	13,537
Per share – basic *($)*	0.56	0.39	0.43	0.43
Per share – diluted *($)*	0.53	0.38	0.42	0.41
Net income	7,433	8,798	5,314	2,065
Per share – basic *($)*	0.24	0.28	0.17	0.07
Per share – diluted *($)*	0.23	0.27	0.16	0.06

Q4 OVERVIEW

Thunder's fourth quarter discussion and analysis is contained in its March 14, 2005 press release, as filed on SEDAR at www.sedar.com.

CRITICAL ACCOUNTING ESTIMATES

As an oil and gas producer, there are a number of critical estimates underlying the accounting policies we apply when preparing our Consolidated Financial Statements. These critical estimates are discussed below.

Oil and Gas Accounting – Reserves Determination

We follow the full cost method of accounting for our oil and gas activities, as described in Note 2 to our Consolidated Financial Statements. Full cost accounting depends on the estimated proven reserves we believe are recoverable from our oil and gas properties. The process of estimating reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering, and economic data. These estimates may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change. Our reserve estimates are based on current production forecasts, prices and economic conditions. Thunder's reserves are evaluated by an independent engineering firm (Gilbert Laustsen Jung Associates Ltd.).

Reserve estimates are critical to many of our accounting estimates, including:

- Calculating our unit-of-production depletion rates and asset retirement obligations. Proven reserve estimates are used to determine rates that are applied to each unit-of-production in calculating our depletion expense.
- Assessing when necessary, our oil and gas assets for possible impairment. Estimated future undiscounted cash flows are determined using proven reserves. The criteria used to assess impairment, including the impact of changes in reserve estimates, are discussed on the following page.

As circumstances change and additional data become available, our reserve estimates also change, possibly materially impacting net income. Estimates made are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although we make every reasonable effort to ensure that our reserve estimates are accurate, reserve estimation is an inferential science. As a result, the subjective decisions, new geological or production information and a changing environment may impact these estimates. Revisions to our reserve estimates can arise from changes in year-end oil and gas prices, and reservoir performance. Such revisions can be either positive or negative.

It would take a very significant decrease in our proven reserves to limit our ability to borrow money under our credit facility.

Asset Impairments

Under full cost accounting, a ceiling test is performed to ensure that unamortized capitalized costs in each cost centre do not exceed their fair value. Impairment is recognized when the carrying amount is greater than the undiscounted future net revenues, at which time assets are written down to the fair value of proved and probable reserves plus the cost of unproved properties, net of impairment allowances. Fair value is determined using expected future product prices and costs, and amounts are discounted using a risk-free interest rate.

Depletion and Depreciation

The Company uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, net of certain costs related to unproved properties including coal bed methane pilot projects, and estimated future development costs is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned, at which point they would be included in the depletion calculation, or for impairment, for which any write-down would be charged to depletion and depreciation.

Goodwill

Goodwill represents the excess of the purchase price of Impact over the fair value of net assets acquired. Goodwill is assessed for impairment at least annually. If it is determined that the fair value of the assets and liabilities is less than the book value at the time of assessment, an impairment amount is determined by deducting the fair value from the book value and applying it against the book value of goodwill. Any excess of the book value of goodwill over the implied fair value is the impairment amount and will be charged to income in the period of the impairment.

Asset Retirement Obligations

Effective January 1, 2004, the Company adopted the new Canadian accounting standard for asset retirement obligations. The new standard requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using a unit of production method over estimated gross proved reserves. Subsequent to the initial measurement of the asset retirement obligations, the obligations are adjusted at the end of each period to reflect the passage of time (accretion) and changes in the estimated future cash flows underlying the obligation.

Stock-based Compensation

As of January 1, 2003, the Company adopted a new accounting standard on stock-based compensation requiring the Company to adopt the fair value method of accounting for stock options. Stock-based compensation expense is recorded for all options granted on or after January 1, 2003, with a corresponding increase recorded to contributed surplus. No compensation expense is recorded for stock options awarded and outstanding prior to adoption of the new accounting standard. The fair value of options granted are estimated at the date of grant using the Black-Scholes valuation model. Upon the exercise of the stock options, consideration paid by employees or directors together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Income Taxes

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from the liability estimated or recorded.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and production costs as at a specific reporting date but for which actual revenues and costs have not yet been received, and estimates on capital projects which are in progress or recently completed where actual costs have not been received at a specific reporting date.

The Company ensures that the individuals with the most knowledge of the activity are responsible for the estimate. These estimates are then reviewed for reasonableness and past estimates are compared to actual results in order to make informed decisions on future estimates.

RISKS AND UNCERTAINTIES

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Thunder will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the cost associated with encountering various drilling conditions such as over-pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Thunder depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Thunder will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Thunder may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Thunder. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of Thunder's oil and gas reserves. Thunder might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Thunder's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Thunder are in part determined by the borrowing base of Thunder. A sustained material decline in prices from historical average prices could limit Thunder's borrowing base; therefore, reducing the bank credit available to Thunder, and could require that a portion of any of Thunder's existing bank debt be repaid.

In addition to establishing markets for its oil and natural gas, Thunder must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas, which may be acquired or discovered by Thunder, will be affected by numerous factors beyond its control. Thunder will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Thunder. The ability of Thunder to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Thunder will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. Thunder has limited direct experience in the marketing of oil and natural gas.

Substantial Capital Requirements; Liquidity

Thunder anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If Thunder's revenues or reserves decline, it may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to Thunder. Moreover, future activities may require Thunder to alter its capitalization significantly. The inability of Thunder to access sufficient capital for its operations could have a materially adverse effect on Thunder's financial condition, results of operations or prospects.

Thunder's lenders have been provided with security over substantially all of the assets of Thunder. If Thunder becomes unable to pay its debt service charges or otherwise commits an event of default, such as bankruptcy, these lenders may foreclose or sell Thunder's properties. Furthermore, Thunder's bank loan is demand in nature and accordingly could be called by the bank at any time, especially if there were an adverse change in the financial position of the Company, although the bank has confirmed that it is not its intention to call for repayment before December 31, 2005. The proceeds of any such sale would be applied to satisfy amounts owed to Thunder's lenders and other creditors and only for the remainder, if any, would be available to Thunder.

Competition

Thunder actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial resources than Thunder. Thunder's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

The oil and gas industry is highly competitive. Thunder's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than Thunder.

Certain of Thunder's customers and potential customers are themselves exploring for oil and natural gas, and the results of such exploration efforts could affect Thunder's ability to sell or supply oil or gas to these customers in the future. Thunder's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and state and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Thunder's financial condition, results of operations or prospects.

Insurance

Thunder's involvement in the exploration for and development of oil and gas properties may result in Thunder becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Thunder has obtained insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the fill extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Thunder may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Thunder. The occurrence of a significant event that Thunder is not fully insured against, or the insolvency of the insurer of such event, could have a materially adverse effect on Thunder's financial position, results of operations or prospects.

Kyoto Protocol

Canada is a signatory to the United Nations Framework Convention on Climate Change. Canada has ratified the Kyoto Protocol established thereunder. Annex B parties to the Kyoto Protocol, which includes Canada, are required to establish legally binding targets to reduce nation-wide emissions of carbon dioxide, methane, nitrous oxide, and other so-called "greenhouse gases". Thunder's exploration and production facilities and other operations and activities emit a small amount of greenhouse gases which may subject Thunder to legislation in Canada regulating emissions of greenhouse gases. The Government of Canada has put forward a Climate Change Plan for Canada which suggests further legislation to set greenhouse gases emission reduction requirements for various industrial activities, including oil and gas exploration and production. Future Canadian federal legislation, together with provincial emission reduction requirements, such as those proposed in the Climate Change and Emissions Management Act (Alberta), may require the reduction of emissions or emissions intensity from Thunder's operations and facilities. The direct and indirect costs of complying with these emissions regulations may adversely affect the business of Thunder.

Reserve Replacement

Thunder's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on Thunder successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves Thunder may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Thunder's reserves will depend not only on Thunder's ability to develop any properties it may have from time to time, but also on its ability to develop any producing properties or prospects. There can be no assurance that Thunder's future exploration and development efforts will result in the discovery of additional commercial accumulations of oil and natural gas.

Reliance on Operators and Key Employees

To the extent Thunder is not the operator of its oil and gas properties, Thunder will be dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the success of Thunder will be largely dependent upon the performance of its management and key employees. Thunder does not have any key man insurance policies; therefore, there is a risk that the death or departure of any member of management or any key employee could have a materially adverse effect on Thunder.

Corporate Matters

To date, Thunder has not paid any dividends on Thunder shares and does not anticipate payment of any dividends on Thunder shares for the foreseeable future. Certain of the directors and officers of Thunder are also directors and officers of other oil and gas companies involved in natural resource exploration and development, and conflicts of interest may arise between their duties as officers and directors of Thunder and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to, such other procedures and remedies as applicable under the Alberta Business Corporations Act.

Permits and Licenses

The operations of Thunder may require licenses and permits from various governmental authorities. There can be no assurance that the issuer will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development at its projects.

Additional Funding Requirements

Thunder's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Thunder may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Thunder to forfeit interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Thunder's revenue from its reserves decreases as a result of lower oil and natural gas prices or otherwise, it will affect Thunder's ability to expend the necessary capital to replace its reserves or to maintain its production. If Thunder's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to Thunder.

From time to time Thunder may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase Thunder's debt levels above industry standards. Neither Thunder's articles nor its by-laws limit the amount of indebtedness that Thunder may incur. The level of Thunder's indebtedness from time to time could impair Thunder's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

Title to Properties

Although title reviews are done according to industry standards prior to the purchase of most oil and natural gas producing properties or the commencement of drilling wells, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise to defeat Thunder's claim which could result in a reduction of the revenue received by the Company.

Aboriginal Claims

Aboriginal people have claimed aboriginal title and rights to portions of western Canada. Thunder is not aware that any claims have been made in respect of its property and assets; however, if a claim arose and was successful this could have an adverse effect on Thunder and its operations.

Delays in Business Operations

In addition to the usual delays in payments by purchasers of oil and natural gas to Thunder or to the operators, and the delays by operators in remitting payment to Thunder, payments between these parties may be delayed due to restrictions imposed by lenders, accounting delays, delays in the sale or delivery of products, delays in the connection of wells to a gathering system, adjustment for prior periods, or recovery by the operator of expenses incurred in the operation of the properties. Any of these delays could reduce the amount of cash flow available for the business of Thunder in a given period and expose Thunder to additional third party-credit risks.

Changes in Legislation

The return on an investment in securities of Thunder is subject to changes in Canadian federal and provincial tax laws and government incentive programs and there can be no assurance that such laws or programs will not be changed in a manner that adversely affects Thunder or the holding and disposing of the securities of Thunder.

Seasonality

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment; thereby, reducing activity levels. Also, certain oil and gas producing areas are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consist of swampy terrain. Seasonal factors and unexpected weather patterns may lead to declines in exploration and production activity and corresponding declines in the demand for the goods and services of Thunder.

Income Taxes

The Company has filed or will file all required income tax returns and believes that it is in full compliance with the provisions of the Income Tax Act (Canada) and all applicable provincial tax legislation; however, such returns are subject to reassessment by the applicable taxation authority. In the event of a successful reassessment of the Company, whether by re-characterization of exploration and development expenditures or otherwise, such reassessment may have an impact on current and future taxes payable.

Assessments of Value of Acquisitions

Acquisitions of oil and gas issuers and oil and gas assets are typically based on engineering and economic assessments made by independent engineers and Thunder's own assessments. Both these assessments will include a series of assumptions regarding such factors as recoverability and marketability of oil and gas, future prices of oil and gas and operating costs, future capital expenditures and royalties and other government levies which will be imposed over the producing life of the reserves. Many of these factors are subject to change and are beyond Thunder's control. In particular, the prices of and markets for oil and natural gas products may change from those anticipated at the time of making such assessment. In addition, all such assessments involve a measure of geologic and engineering uncertainty which could result in lower production and reserves than anticipated. Initial assessments of acquisitions may be based on reports by a firm of independent engineers that are not the same as the firm that Thunder uses for its year-end reserve evaluations.

Accounting Write-Downs as a Result of GAAP

Canadian generally accepted accounting principles require that management apply certain accounting policies and make certain estimates and assumptions which affect reported amounts in the consolidated financial statements of Thunder. The accounting policies may result in non-cash charges to net income and write-downs of net assets in the financial statements. Such non-cash charges and write-downs may be viewed unfavorably by the market and result in an inability to borrow funds and/or may result in a decline in the trading price of Thunder's shares.

Under GAAP, the net amounts at which petroleum and natural gas costs on a property or project basis are carried are subject to a cost-recovery test which is based in part upon estimated future net cash flow from reserves. If net capitalized costs exceed the estimated recoverable amounts, Thunder would have to charge the amounts of the excess to earnings. A decline in the net value of oil and natural gas properties could cause capitalized costs to exceed the cost ceiling, resulting in a charge against earnings.

Goodwill is assessed for impairment annually. If it is determined that the fair value of the assets and liabilities is less than the book value at the time of the assessment, an impairment amount is determined by deducting the fair value from the book value and applying it against the book value of goodwill. Any excess of the book value of goodwill over the implied fair value is the impairment amount and will be charged to income in the period of the impairment.

Third Party Credit Risk

Thunder is or may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to Thunder, such failure could have a materially adverse effect on Thunder and its cash flow from operations.

MANAGEMENT'S REPORT

The accompanying consolidated financial statements of Thunder Energy Inc. have been prepared by management in accordance with Canadian generally accepted accounting principles applied on a consistent basis. The Company's accounting procedures and related systems of internal controls are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. In recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared accordingly and within reasonable limits of materiality. Further, management is satisfied that the financial information throughout the balance of this annual report is consistent with the information presented in the financial statements.

Ernst & Young LLP have been appointed by the shareholders of Thunder and serve as the Company's independent auditors. They have examined the financial statements of the Company for the year ended December 31, 2004. The Audit Committee has reviewed these statements with management and the auditors, and has reported to the Board of Directors. The Board has approved the financial statements of Thunder which are contained in this annual report.

Douglas A. Dafoe
President and Chief Executive Officer

Brent T. Kirkby
Vice President, Finance and Chief Financial Officer

March 11, 2005

Auditors' Report

To the Shareholders of Thunder Energy Inc.

We have audited the consolidated balance sheets of Thunder Energy Inc. as at December 31, 2004 and 2003 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Calgary, Canada
Chartered Accountants

March 11, 2005

Consolidated Balance Sheets

As at December 31 *($000s)*	2004	2003
		(restated – Note 3)
Assets *(Note 6)*		
Current		
Cash	$ 21	$ –
Accounts receivable *(Note 9)*	23,728	11,343
Prepaid expenses	953	848
	24,702	12,191
Property and equipment *(Note 5)*	406,082	225,909
Goodwill *(Note 4)*	45,448	–
	$ 476,232	$ 238,100
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness	$ 1,568	$ 1,923
Accounts payable and accrued liabilities	47,581	18,738
Revolving demand loan *(Note 6)*	82,896	74,348
	132,045	95,009
Capital lease obligations	94	138
Asset retirement obligations *(Note 3)*	13,417	10,352
Future income taxes *(Note 8)*	66,934	35,652
	212,490	141,151
Shareholders' equity		
Share capital *(Note 7)*	189,573	41,081
Contributed surplus *(Note 7)*	2,836	463
Retained earnings	71,333	55,405
	263,742	96,949
	$ 476,232	$ 238,100

See accompanying notes

On behalf of the Board:

J.M. Pasieka

J.M. Pasieka
Director

J. Clark
Director

Consolidated Statements of Income and Retained Earnings

Years Ended December 31 *($000s, except per share data)*	2004	2003
		(restated – Note 3)
Revenue		
Petroleum and natural gas sales	$ 116,409	$ 102,201
Royalties, net of ARTC	(20,922)	(21,607)
Transportation expenses	(4,225)	(4,011)
Petroleum and natural gas sales, after royalties and transportation	91,262	76,583
Expenses		
Operating	19,299	14,480
General and administrative	4,264	2,249
Stock-based compensation *(Note 7)*	2,514	463
Interest	3,094	2,740
Depletion, depreciation and accretion	36,200	22,935
	65,371	42,867
Income before taxes	25,891	33,716
Provision for income taxes *(Note 8)*	9,963	10,106
Net income for the year	15,928	23,610
Retained earnings		
Beginning of year	55,405	33,862
Retroactive application of change in accounting policy *(Note 3)*	–	(2,067)
End of year	$ 71,333	$ 55,405
Shares outstanding (weighted average)		
Basic	44,214	31,414
Diluted	45,250	32,645
Net income per share		
Basic	$ 0.36	$ 0.75
Diluted	$ 0.35	$ 0.72

See accompanying notes

Consolidated Statements of Cash Flows

Years Ended December 31 *($000s)*	2004	2003
		(restated – Note 3)
Operating Activities		
Net income for the year	$ 15,928	$ 23,610
Add items not requiring cash:		
Stock-based compensation	2,514	463
Depletion, depreciation and accretion	36,200	22,935
Future income taxes *(Note 8)*	9,336	9,710
Cash flow from operations	63,978	56,718
Site restoration and abandonment	(159)	(124)
Changes in non-cash working capital related to operating activities	(10,391)	(671)
Cash provided by operating activities	53,428	55,923
Financing Activities		
Issue of common shares for cash, net of costs	12,237	1,154
Increase in revolving demand loan	8,548	8,870
Decrease in bank indebtedness	(355)	1,440
Cash provided by financing activities	20,430	11,464
Investing Activities		
Expenditures on property and equipment	(93,245)	(69,943)
Assumption of working capital *(Note 4)*	(6,220)	–
Transaction costs on Impact acquisition *(Note 4)*	(1,116)	–
Changes in non-cash working capital related to investing activities	26,744	2,556
Cash used in investing activities	(73,837)	(67,387)
Net change in cash position	21	–
Cash position – beginning of year	–	–
Cash position – end of year	$ 21	$ –

See accompanying notes

Notes to the Consolidated Financial Statements

1 Nature of Operations

Thunder Energy Inc. (the "Company") was incorporated under the laws of the Province of Alberta on October 17, 1995. On April 30, 2004, Thunder purchased all of the outstanding shares of Impact Energy Inc. ("Impact"). The transaction was accounted for using the purchase method. Accordingly, the consolidated financial statements include those of the Company from inception and those of the combined companies from the date of acquisition to December 31, 2004. All intercompany transactions and balances have been eliminated.

The Company's primary business is the acquisition of, and the exploration for and development and production of crude oil and natural gas. The Company has properties in both Canada and the United States. The Company has no proven reserves in the United States and the holdings are not significant to the consolidated financial statements. All activity is conducted in Western Canada and comprises a single business unit.

2 Significant Accounting Policies

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated.

Specifically, the amounts recorded for depletion, depreciation and accretion of oil and natural gas properties and equipment and asset retirement obligations are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated.

Petroleum and natural gas properties and gas plants and related facilities

The Company follows the full cost method of accounting whereby all costs associated with the acquisition of and the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in one Canadian cost centre and charged to income as set out below. Such costs include lease acquisition, drilling, equipping, geological and geophysical costs and overhead expenses directly related to exploration and development activities. No indirect general and administrative costs have been capitalized.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

Depletion and depreciation

Depletion of petroleum and natural gas properties is provided on accumulated costs using the unit of production method based on estimated gross proven petroleum and natural gas reserves, as determined by independent engineers. For purposes of the depletion calculation, proven petroleum and natural gas reserves are converted to a common unit of measure on the basis of one barrel of oil or liquids being equal to six mcf of natural gas. Costs of acquiring and evaluating unproven properties are excluded from depletion calculations until it is determined whether or not proven reserves are attributable to the properties or impairment occurs.

Depreciation of gas plants and related facilities is calculated on a straight-line basis over their estimated useful lives of fifteen years. Assets under capitalized lease are amortized on a straight-line basis over the three-year life of the lease.

The Company records other assets at cost and provides depreciation on the declining balance method at rates varying from 20% to 100% per annum which is designed to amortize the cost of the assets over their estimated useful lives.

Ceiling test

As of January 1, 2003, the Company adopted a new accounting standard on impairment recognition for oil and gas assets. As permitted under the standard, the Company tests impairment against undiscounted future net revenues from proven reserves using expected future product prices and costs. Impairment is recognized when the carrying amount is greater than the undiscounted future net revenues, at which time assets are written down to the fair value of proved and probable reserves plus the cost of unproved properties, net of impairment allowances. Fair value is determined using expected future product prices and costs, and amounts are discounted using a risk free interest rate.

Goodwill

Goodwill, at the time of acquisition, represents the excess of the purchase price of a business over the fair value of net assets acquired; thereafter, goodwill is assessed for impairment at least annually. If the fair value of the business is less than the book value, a second test is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the business' assets and liabilities from the fair value of the business to determine the implied fair value of goodwill and comparing that amount to the book value of goodwill. Any excess of the book value of goodwill over the implied fair value is the impairment amount and will be charged to income in the period of the impairment.

Joint interest operations

A portion of the Company's petroleum and natural gas activities are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

Revenue recognition

Revenue form the sale of petroleum and natural gas is recognized during the month when title passes.

Transportation costs

Effective January 1, 2004, and consistent with the adoption of CICA Handbook Section 1100, "Generally Accepted Accounting Principles", transportation costs are presented as an expense in the Statements of Income and Retained Earnings. Previously these amounts were netted against revenue. Prior periods have been reclassified to conform to the presentation adopted in 2004.

Per share amounts

Basic per share amounts are computed by dividing earnings by the weighted average number of common shares outstanding for the period. The treasury stock method is used to determine the diluted per share amounts. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds that arise from the exercise of outstanding, in the money options are used to purchase common shares of the Company at their average market price for the period.

Stock-based compensation

The Company has a stock-based compensation plan, which is described in Note 7. As of January 1, 2003, the Company adopted a new accounting standard on stock-based compensation requiring the Company to adopt the fair value method of accounting for stock options. Stock-based compensation expense is recorded for all options granted on or after January 1, 2003, with a corresponding increase recorded to contributed surplus. No compensation expense is recorded for stock options awarded and outstanding prior to adoption of the new accounting standard. The fair value of options granted are estimated at the date of grant using the Black-Scholes valuation model. Upon the exercise of the stock options, consideration paid by employees or directors together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Flow-through shares

A portion of the Company's exploration and development activities is financed through proceeds received from the issue of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to the share subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers. The tax effect of the renouncement is recorded when the renouncements related to the corresponding exploration and development expenditures are filed.

Income taxes

The liability method is used in accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change occurs.

Financial instruments

Effective January 1, 2004 the Company implemented CICA Accounting Guideline 13 “Hedging Relationships”. The new standard requires the identification, designation and documentation of each hedging relationship as well as an assessment of the effectiveness of the hedging relationship for the purposes of applying hedge accounting. The adoption of the guideline had no impact on the Company’s financial position or results of operations.

Comparative amounts

Certain comparative amounts have been reclassified to conform to the presentation adopted for the current period.

3 CHANGE IN ACCOUNTING POLICY REQUIRED BY A CHANGE IN GAAP

Effective January 1, 2004, the Company adopted the new Canadian accounting standard for asset retirement obligations. The new standard requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using a unit of production method over estimated gross proved reserves. Subsequent to the initial measurement of the asset retirement obligations, the obligations are adjusted at the end of each period to reflect the passage of time (accretion) and changes in the estimated future cash flows underlying the obligation.

The effect of this change in accounting policy has been recorded retroactively with restatement of prior periods. The effect of the adoption is presented below as increases (decreases):

Balance sheet *($000s)*	As at December 31, 2003
Asset retirement costs, included in property and equipment	8,133
Accumulated amortization on asset retirement costs included in property and equipment	3,077
Asset retirement obligations	10,352
Accumulated future removal and site restoration liability	(1,526)
Future income tax liability	(1,214)
Retained earnings	(2,556)

Income statement *($000s, except per share data)*		Year ended December 31, 2003
Accretion expense		702
Depletion and depreciation on asset retirement costs		665
Provision for estimated future removal and site restoration liability		(663)
Net income impact		(489)
Basic net income per share	$	(0.02)
Diluted net income per share	$	(0.02)

The Company’s asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately $30 million which will be incurred between 2005 and 2034. The majority of the costs will be incurred between 2010 and 2034. A credit-adjusted risk-free rate of 8.5 percent and an inflation rate of 1.5 percent were used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

Asset retirement obligations *($000s)*	2004	2003
Balance, beginning of period	$ 10,352	$ 8,258
Liabilities incurred in the period	2,271	1,516
Liabilities settled in the period	(159)	(124)
Accretion expense	953	702
Balance, end of period	$ 13,417	$ 10,352

4 Business Combination

On April 30, 2004, the Company acquired all of the issued and outstanding common shares of Impact Energy Inc. ("Impact") on the basis of 0.22222 common shares of Thunder for each common share of Impact. The value per common share issued was calculated as the average Thunder closing share price five days before and five days after the announcement of the acquisition. Thunder issued 18,100,317 common shares as consideration and incurred $1.1 million in transaction costs. Subsequent to the date of acquisition the preliminary allocation of the purchase price was adjusted to reflect Thunder's current understanding of fair values as at the date of acquisition. This transaction was accounted for by the purchase method, based on fair values as follows:

Net assets acquired *($000s)*	
Current assets, including cash of $14	$ 2,692
Property and equipment	120,727
Goodwill	45,448
Current liabilities	(8,912)
Asset retirement obligations	(778)
Future income tax liability	(22,226)
	$ 136,951
Value of common shares of Thunder issued	$ 135,835
Transaction costs	1,116
Total consideration	$ 136,951

5 Property and Equipment

($000s)	Cost	Accumulated depletion and depreciation	Net book value
2004			
Petroleum and natural gas properties	379,490	80,128	299,362
Gas plants and related facilities	130,319	24,540	105,779
Office equipment	1,336	419	917
Assets under capital lease	248	224	24
	511,393	105,311	406,082
2003			
Petroleum and natural gas properties	214,199	52,417	161,782
Gas plants and related facilities	80,628	17,065	63,563
Office equipment	834	397	437
Assets under capital lease	249	122	127
	295,910	70,001	225,909

At December 31, 2004, costs of $46,288,400 (2003 – $9,884,600) related to unproven properties, including costs associated with coal bed methane pilot projects, have been excluded from the depletion calculation.

Thunder performed a ceiling test calculation at December 31, 2004 to assess the recoverable value of its petroleum and natural gas interests. The oil and gas future prices are based on January 1, 2005 benchmark reference prices and adjusted for commodity price differentials specific to Thunder. Based on these assumptions, there was no impairment at December 31, 2004. The following table summarizes the benchmark reference prices used in the ceiling test calculation:

Year	WTI Oil *($US/bbl)*	Edmonton Light Crude Oil 40° API *($Cdn/bbl)*	Henry Hub Gas Price *($US/mmbtu)*	AECO Natural Gas Price *($Cdn/mmbtu)*
2005	42.00	50.25	6.20	6.60
2006	40.00	47.75	6.00	6.35
2007	38.00	43.25	5.75	6.15
2008	36.00	40.75	5.50	6.00
2009	34.00	39.50	5.50	6.00
Escalate thereafter	2.0% per year	2.0% per year	2.0% per year	2.0% per year

6 Revolving Demand Loan

The Company has a $130 million credit facility consisting of a revolving demand loan with a syndicate of Schedule One Canadian chartered banks that bears interest at the bank's prime rate. The Company has pledged all of its assets as collateral for loans under the facility.

At December 31, 2004, the effective interest rate on the debt outstanding was 3.9% (2003 – 4.1%). Interest paid during the years ended December 31, 2004 and 2003 approximates interest expense in each year.

While the credit facility is demand in nature, the bank has stated that it is not its intention to call for repayment before December 31, 2005 provided there is no adverse change in the financial position of the Company.

7 Share Capital

Authorized

Unlimited number of voting common shares with no par value

Unlimited number of non-voting preferred shares issuable in series

Issued

Common shares	Number of shares	$ Thousands
Balance December 31, 2002	30,972,227	39,927
Issued for cash on exercise of stock options	589,835	1,154
Balance December 31, 2003	31,562,062	41,081
Issued for cash on exercise of stock options	1,000,602	3,091
Issued on Impact acquisition *(Note 4)*	18,100,317	135,835
Share issue costs, net of tax of $68	–	(101)
Flow-through shares issued for cash	1,000,000	10,000
Share issue costs, net of tax of $212	–	(333)
Balance December 31, 2004	51,662,981	189,573

Stock-based Compensation

The Company has established a stock option plan whereby options may be granted to the Company's directors, officers and employees for up to 4,598,000 common shares. The exercise price of each option equals the market price of the Company's stock on the date of the grant. An option's maximum term is five years and the options vest equally over three years beginning at the date the option is granted. The following is a continuity of stock options outstanding for which shares have been reserved:

	2004		2003	
	Options	Weighted-average exercise price	Options	Weighted-average exercise price
Opening	2,873,498	$ 3.57	2,611,667	$ 2.45
Granted	2,805,000	7.76	880,000	5.79
Exercised	(1,000,602)	2.96	(589,835)	1.97
Cancelled	(324,166)	7.53	(28,334)	3.35
Closing	4,353,730	$ 6.11	2,873,498	$ 3.57

As at March 11, 2005, there were 51,714,182 common shares and stock options to acquire an aggregate of 4,170,029 common shares outstanding. As a result of the arrangement with Impact Energy Inc., there were 18,100,317 common shares issued. In December 2004 the Company issued 1,000,000 flow-through shares at $10 per share. The tax credits associated with expenditures to be funded by this offering will be renounced under the look-back rule in 2005 when the expenditures will be incurred; therefore, no future tax liability has been booked as at December 31, 2004.

The following summarizes information about stock options outstanding at December 31, 2004:

Grant price	Options outstanding	Weighted-average remaining contractual life	Weighted-average exercise price	Number exercisable (vested)	Weighted-average exercise price (vested)
$ 1.70 – $ 3.00	815,900	0.54	$ 2.30	815,900	$ 2.30
$ 3.01 – $ 5.00	339,498	1.66	$ 3.73	339,498	$ 3.73
$ 5.01 – $ 7.00	808,332	3.67	$ 5.99	220,017	$ 5.79
$ 7.01 – $ 8.39	2,390,000	4.40	$ 7.80	–	–
$ 1.70 – $ 8.39	4,353,730	3.33	$ 6.11	1,375,415	$ 3.21

8 Income Taxes

Income taxes recorded in the consolidated statements of income and retained earnings differ from the tax calculated by applying the combined Canadian corporate federal and provincial income tax rate to income before taxes as follows:

($000s, except where noted)	2004	2003
Statutory income tax rate for the period	38.94%	40.75%
Computed income tax expense	$ 10,082	$ 13,739
Add (deduct) income tax effect of:		
Non deductible Crown charges, net of ARTC	4,749	6,261
Resource allowance	(4,930)	(6,612)
Tax rate adjustments	(1,569)	(3,877)
Stock-based compensation	979	189
Other	25	10
Future income tax	9,336	9,710
Large corporation tax	627	396
Provision for income taxes	$ 9,963	$ 10,106
Effective tax rate	38%	30%

The primary components of the future net income tax liability relate to the following:

($000s)	2004	2003
Property and equipment	54,779	31,937
Deferral of partnership income	19,754	6,214
Tax loss carry forwards recognized	(1,441)	–
Attributed Canadian royalty income	(819)	(619)
Asset retirement obligation	(4,511)	(1,680)
Share issue costs	(783)	(166)
Other	(45)	(34)
Net future income tax liability	66,934	35,652

Taxes paid approximate large corporation tax expense for each of the years ended December 31, 2004 and 2003.

9 Risk Management

a) Credit risk

A substantial portion of the Company's accounts receivable are with oil and gas marketing entities. The Company generally extends unsecured credit to these companies; therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Management believes the risk is mitigated by the size, reputation and diversified nature of these companies to which they extend credit.

The Company has not previously experienced any material credit losses on the collection of receivables. Of the Company's significant individual accounts receivable at December 31, 2004, approximately 37% was owing from one customer (December 31, 2003 – 42% from two customers) of which 34% represented cash calls. Subsequent to year-end, 73% was settled.

b) Fair value of financial instruments

The carrying amounts of financial instruments included in the balance sheet, other than the bank loan, approximate their fair value due to the short-term maturity.

The Company was party to an off-balance sheet power contract, a derivative financial instrument in 2004 and 2003. The contract fixes the price of twenty-four megawatt hours ("MWh") of electricity per day at $78.00 per MWh and runs through December 31, 2005. Operating expenses for the year ended December 31, 2004 include costs of $206,000 (2003 – $131,000) associated with this contract. At December 31, 2004 this contract was out of the money by $320,000. This value is based upon the fair market value of the contract at December 31, 2004 and represents the amount the Company would be required to pay to terminate the contract. This instrument has no book value recorded in the consolidated financial statements.

10 Related Party Transactions

During the year the Company paid $331,000 (2003 – $53,000) for legal services from a law firm of which one of the Company's directors is a partner. At December 31, 2004, $64,000 ($Nil) remained outstanding. These transactions were in the normal course of operations and were measured at the exchange amount.

11 Subsequent Event

On March 11, 2005, the Board of Directors authorized management of Thunder to undertake examination of possible corporate restructuring alternatives to increase shareholder value. No decision on any particular alternative has been reached and there can be no assurance that the Board of Directors will determine to undertake any transaction identified and presented to it by management.

Corporate Information

Directors

James M. Pasieka[2]
Chairman of the Board
Barrister & Solicitor
Heenan Blaikie LLP

Donald F. Archibald
Chairman and Chief Executive Officer
Cyries Energy Inc.

Jack W. Peltier[1, 3]
President
Ipperwash Resources Ltd.

Colin D. Boyer, P.Eng.[1, 2, 3]
President
Birchill Resources Partnership

Douglas A. Dafoe, C.A.
President and
Chief Executive Officer
Thunder Energy Inc.

John Clark[1, 3]
President
Investments and Technical
Management Corp.

John Barford[2]
Chairman
GSW Inc.

[1] Audit Committee
[2] Compensation Committee
[3] Reserve Evaluation Committee

Officers

Douglas A. Dafoe, C.A.
President and Chief Executive Officer
Thunder Energy Inc.

Terry S. Meek, P.Eng.
Vice President, Engineering and
Chief Operating Officer
Thunder Energy Inc.

Kelvin Johnston, P.Geol.
Vice President, Exploration
Thunder Energy Inc.

Brent T. Kirkby, CMA
Vice President, Finance and
Chief Financial Officer
Thunder Energy Inc.

Steven R. Gell, P.Eng.
Vice President, Production
Thunder Energy Inc.

Thomas A. Zuorro
Vice President, Land
Thunder Energy Inc.

Felicia B. Bortolussi
Corporate Secretary
Barrister & Solicitor
Heenan Blaikie LLP

Abbreviations

bbl(s)	barrel(s)
mbbls	thousand barrels
mmcf	million cubic feet
bcf	billion cubic feet
boe	barrel of oil equivalent (6 mcf = 1 bbl)
/d	per day
API	American Petroleum Index
NGLs	natural gas liquids
CBM	coal bed methane

Independent Engineers

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Calgary, Alberta

Auditors

Ernst & Young LLP
Calgary, Alberta

Legal Counsel

Heenan Blaikie LLP
Calgary, Alberta

Bankers

Bank of Montreal
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Transfer Agent & Registrar

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